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When Governor Schwarzenegger took office in November of 2003, the state faced a structural budget crisis of unprecedented proportions. A review of state finances projected that California was on a path to spend \$16.5 billion more than the General Fund revenue it would take in this year. In contrast, the Governor's Budget for 2007-08 proposes to limit General Fund spending to the amount of revenue the state will collect, with the exception that it proposes to use \$840 million of funds available from previous years to pre-pay debt. By eliminating the state's net operating deficit, by setting aside a total reserve of \$2.1 billion and by eschewing tax increases and new budgetary borrowing, this budget puts California on the path to full fiscal recovery.

PAYING DOWN THE DEBT

In 2004-05 the state used the Economic Recovery Bonds (ERBs) authorized by the voters in Proposition 57 to refinance \$11.3 billion of budgetary debt inherited from the prior administration. In addition to the ERB borrowing, as of the end of the 2004-05 budget year, the state owed \$6.9 billion for other budgetary borrowing, such as debt to local governments for un-reimbursed mandate claims and borrowing from Proposition 42 and other special funds. Repaying the bonds and the other budgetary debt has been a high priority of the administration and the Legislature. Specifically, the Budget Act of 2005 repaid budgetary borrowing of \$1.4 billion and the Budget Act of 2006 repaid \$2.8 billion, including \$472 million in pre-payments of the ERBs.

This budget proposes \$1.6 billion in pre-payments of the ERBs and \$88 million of other budgetary debt re-payments. This will bring the total amount set aside to repay the ERBs to \$7.4 billion in just the four years since the bonds were first issued. As a result, we now

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project that the ERBs will be fully retired in August of 2009, which is 14 years ahead of schedule.

PROTECTING PRIORITIES

This budget funds key priorities, including:

- Fully funding the Proposition 98 guarantee at \$56.8 billion. This is an increase of \$1.8 billion from all funds and \$378 million from the General Fund. The General Fund share of the Proposition 98 guarantee amounts to 40 percent of total General Fund expenditures in 2007-08.
- Fully funding the Governor's Compacts with Higher Education (\$346 million General Fund) and the state Judiciary and trial courts (\$147 million General Fund).
- Providing \$52 million to expand Career Technical Education (CTE) course offerings and programs. In an ever-evolving economy, Californians need multiple pathways to rewarding and productive careers. The Administration remains committed to expanding opportunities for high school and community college students to take high-quality, academically rigorous CTE courses.
- Fully funding the \$217 million cost of providing cost-of-living adjustments for aged, blind and disabled SSI/SSP recipients.
- Providing \$58 million in 2006-07 and \$193 million in 2007-08 for a comprehensive Sex Offender Management Plan including funds to implement Proposition 83 ("Jessica's Law"), the Governor's High Risk Sex Offender Task Force recommendations, and recently enacted legislation.
- Providing necessary funds for the California Department of Corrections and Rehabilitation for the federal court-appointed Receiver to improve the state's prison health care delivery system. Specifically, the Budget proposes to increase the budget set-aside for prison health care from \$100 million to \$150 million in 2007-08.
- Providing \$36 million to begin to implement California's landmark Greenhouse Gas Reduction Efforts.
- Providing \$95 million for the most advanced research in the world, as part of the Governor's Strategic Research and Innovation Initiative. The Budget provides \$30 million in lease revenue bonds for the Helios Project, \$40 million for the Energy Biosciences Institute, \$19.8 million for the California Institutes for Science and Innovation,

and \$5 million for the Petascale Supercomputer project. These funds have the potential to leverage private and federal funding in excess of \$1 billion.

- Expanding health care coverage by providing \$36 million (\$17 million General Fund) and 9.4 positions in 2007-08 for SB 437 implementation activities and enrollment increases. SB 437 (Chapter 328, Statutes of 2006) establishes a two-county pilot program to allow parents to self-certify income and assets when enrolling their children into Medi-Cal and during the annual eligibility review process. SB 437 allows self-certification of income at the annual eligibility review process for the Healthy Families Program (HFP). In addition, when new children apply for Medi-Cal and are found ineligible, but appear eligible for the HFP, counties will be able to enroll them in the HFP so that the child's health coverage is not delayed.
- Including \$2 million to improve the state's food-borne illness emergency response capability, as well as \$1.5 million to begin implementing the new environmental contaminant biomonitoring program authorized by Chapter 599, Statutes of 2006 (SB 1379). This funding will be used to develop sampling design and establish parameters for this program. This proposal is a collaborative effort between the Department of Public Health, Office of Environmental Health Hazard Assessment, and the Department of Toxic Substances Control.
- Providing funding to implement two bills chaptered in 2006 that will provide millions of low-income Californians with discounted prescription drugs: Chapter 619, Statutes of 2006 (AB 2911), will deliver prescription drugs at prices up to 40 to 60 percent below retail prices for generic and brand name drugs to individuals. Chapter 720, Statutes of 2006 (AB 2877), authorized the California Rx Prescription Drug Website, which will provide information to Californians about available options for obtaining prescription drugs at affordable prices.

REDUCING THE OPERATING DEFICIT

In order to fund these and other priorities within a balanced budget while pre-paying debt and maintaining a sizeable reserve, the budget proposes the following major policy changes:

- Reducing General Fund costs by \$1.111 billion by expanding the uses of revenues sources for public transportation to:
 - Cover public transportation services currently provided by the schools (\$627 million, ongoing);

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- Cover public transportation services currently provided by Regional Centers to their developmentally disabled clients (\$144 million, one-time), and;
- Shift a portion of the revenue to a special fund for debt service on general obligation bonds issued for transportation projects (\$340 million, one-time).
- Revenues of \$506 million from approval of pending Indian gaming compacts.
- Savings of \$324 million related to reforms in CalWORKs-the state's welfare-to-work program.
- Utilizing \$269 million in Proposition 98 funds for Stage 2 Child Care.
- Reimbursing \$200 million in General Fund spent for flood protection and levee repair with bond funds approved for that purpose by voters in last fall's election.
- Revenues of \$165 million by repealing the Teacher Tax Credit.
- Suspending the July 1, 2007, CalWORKs cost-of-living adjustment, resulting in savings of \$140 million.
- Savings of \$100 million resulting from parole modifications for non-serious/non-violent offenders (\$53 million), elimination of 90-day diagnostic evaluations in adult institutions (\$4 million), the shift of certain juvenile offender populations to the counties (\$33 million), and elimination of funding for the Juvenile Justice Community Reentry Challenge Grant (\$10 million).
- Budget reduction of \$100 million to be allocated to departments. The Department of Finance will work with Agency Secretaries and other cabinet members to achieve additional General Fund savings of \$100 million in 2007-08.
- Savings of \$75 million resulting from providing purchasing power protection for retired teachers as a vested benefit while reducing state's contribution to the State Teachers' Retirement System Supplemental Benefits Maintenance Account from 2.5 percent to 2.2 percent of teacher payroll.
- Eliminating state funding for the Integrated Services for Homeless Adults with Serious Mental Illness program, resulting in ongoing savings of \$55 million.
- Revising the bundled reimbursement rate for intermediate care facilities for the developmentally disabled to include Day Programs and Non-Medical Transportation, in order to obtain \$44 million in additional annual federal funding to replace the General Fund costs of providing those services.

- Savings of \$44 million in 2007-08 and \$88 million annually thereafter by switching the basis for Medi-Cal pharmaceutical reimbursement from the Average Wholesale Price to Average Manufacturers Price, thus using the actual cost of production and minimizing any potential cost-shifting to Medi-Cal from other drug purchasers.
- Revenues of \$35 million by making permanent the use tax on vessels, vehicles, and aircraft brought into the state less than one year from purchase.
- Savings of \$25 million on a one-time basis in 2007-08 by reducing Proposition 36 funding by \$60 million and using a portion of this funding to provide a net increase of \$35 million to the Substance Abuse Offender Treatment Program, allowing the state to pursue reforms to drug treatment programs and services that lead to improved program performance and patient outcomes.

In addition, the Administration has exercised restraint in funding program growth. Total General Fund spending proposed in the budget is \$103.1 billion, which is \$1 billion, or less than one percent, more than in the current year. This represents the lowest rate of growth in General Fund spending in five years.

While these actions will bring about a balanced budget in 2007-08 with a substantial reserve and no net operating deficit, spending pressures will push the budget back into deficit in subsequent fiscal years if left unchecked.

BUDGET REFORM

While this budget proposes ongoing spending that is aligned with ongoing revenues, the structural deficit can re-emerge as early as the next budget year. To prevent this, the state needs to find ways to (1) keep spending in check in the long run and (2) reduce the volatility of state revenues. Toward these ends the Governor will work with the Legislature to develop and enact real budget reform.

THE CALIFORNIA STRATEGIC GROWTH PLAN

In November 2006, California voters approved the landmark \$37.3 billion Strategic Growth Plan (SGP) and a \$5.4 billion bond initiative for natural resource protection, water, and parks. The Governor proposes to complete the financing plan to rebuild California's infrastructure through 2016 by addressing the critical gaps that remain.

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To continue rebuilding California, the Governor is proposing a combination of new general obligation, lease-revenue and self-liquidating revenue bonds totaling \$43.3 billion to finance the SGP through 2016:

- \$9.5 billion for state and local correctional facilities;
- \$11.6 billion for K-12 education facilities;
- \$11.6 billion for Higher Education facilities;
- \$6.0 billion for water supply and management;
- \$2.0 billion for the state's judiciary facilities; and
- \$2.6 billion for other public service infrastructure.

Combined with the bonds already approved by the voters, other existing funding sources and leveraged funding through the use of public private partnerships, total funding for the SGP will be \$211 billion.

The California SGP includes additional accountability and performance measures to ensure that all the bonds are used appropriately and effectively to meet the goals approved by the Governor, the Legislature and the voters.